No. 88-1400

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In The

Supreme Court of the United States

October Term, 1988

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B. M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,

Petitioners,

v.

ALCAN ALUMINIUM LIMITED AND IMPERIAL CHEMICAL INDUSTRIES PLC,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONERS

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QUESTIONS PRESENTED

1. Whether a foreign company which is the sole stockholder of an American subsidiary has standing to challenge in federal court the accounting method by which the State of California determines the locally taxable income of that subsidiary.

2. Whether, assuming that requisite standing exists in such an instance, a federal action for injunctive and declaratory relief is nevertheless barred by the Tax Injunction Act (28 U.S.C. § 1341) or the principle of comity which underlies the Act.

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BRIEF FOR THE PETITIONERS

OPINIONS BELOW

The decision of the Court of Appeals for the Seventh Circuit (Pet. App., Al-A20) is reported at 860 F. 2d 688. The opinion of the District Court for the Northern District of Illinois, Eastern Division (Pet. App., A21-A27) is not reported.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on October 19, 1988. A petition for rehearing en banc was denied on January 9, 1989. On January 24, 1989, the Court of Appeals granted petitioners' motion for a stay of mandate for a period of 30 days to enable petitioners to file a petition for a writ of certiorari. The petition for a writ of certiorari was filed on February 22, 1989 and was granted on April 17, 1989. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

28 U.S.C. § 1341:

"The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

STATEMENT OF THE CASE

A. General Background.

The consolidated actions in this matter were brought by two foreign corporations seeking to challenge, by way of declaratory and injunctive relief, the unitary business/formula apportionment method of accounting under which the Franchise Tax Board of the State of California has proposed to determine the taxable income of the foreign companies' American subsidiaries properly allocable to California.[1] The two suits were filed in the

[1] In *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court upheld the constitutionality of California's

(Continued on following page)

Northern District of Illinois, with jurisdiction over the subject matter being based on 28 U.S.C. §§ 1331, 1337, 1343 and 2201. Named defendants in one suit are the Franchise Tax Board and two employees assigned to its Chicago office; in the other, the Franchise Tax Board and a single Chicago employee. Said party-defendants are hereinafter collectively referred to as "the Board."

Plaintiffs-respondents are Alcan Aluminium Ltd. ("Alcan") and Imperial Chemical Industries PLC ("Imperial"). Alcan, a Canadian company, is the indirect parent of Alcan Aluminum Corporation ("Alcancorp"), a company organized under the laws of Ohio. Imperial, a British company, is the indirect parent of ICI Americas, Inc. ("Americas"), a company organized under the laws of Delaware.[2] Although Alcancorp and Americas are the

(Continued from previous page)

method of taxation as applied to a domestic company with foreign subsidiaries, rejecting the contention that California was required to determine the locally taxable income of that company under the separate accounting/arm's length method of taxation used by the Federal Government and various foreign jurisdictions. However, the Court specifically left open the question whether the unitary business/formula apportionment method of accounting is constitutionally permissible when the taxpayer is a domestic subsidiary of a foreign parent. See 463 U.S., at 189, n. 26. That ultimate issue is not before this Court at this time. Only if this Court were to decide both the standing issue and the section 1341/comity issues against California's position would that ultimate constitutional issue be ripe for consideration on the merits by the District Court on remand.

[2] Since during the income years involved both Alcan and Imperial were ultimate parents of wholly-owned chains of subsidiaries leading to Alcancorp and Americas, respectively, Alcan and Imperial shall be referred to herein as the "sole stockholders" of their respective subsidiaries.

corporate taxpayers involved here, neither is a party to either lawsuit.

During the years in question, the two American subsidiaries, Alcancorp and Americas, conducted business in California and were therefore subject to the state's corporate tax laws. The Board has determined that the taxable income of those companies should be calculated under the unitary business/formula apportionment method of accounting. Under this method of accounting, the results and activities of all commonly controlled entities which function as a single or unitary business are combined and a portion of such overall results is then assigned to California based on a comparison of the activities conducted in California to the activities of the unitary business everywhere. Generally the comparison is made by employment of a three-factor formula based on relative property, payroll and sales.

For purposes of this litigation, neither respondent has contested the Board's findings that their respective subsidiaries were engaged in unitary enterprises with their parent companies. JA 54, 63.[3] Both contend, however, that the Board's use of the unitary business/formula apportionment method of accounting to calculate the taxable income of their respective subsidiaries imposes an unconstitutional burden on the conduct of foreign commerce.

The allegations in the complaints filed by the two parent companies, both of which refer to California's

[3] Stipulations of fact (JA 37 – 100, 131-132), with voluminous exhibits attached, were filed in the District Court in anticipation of the legal issues in the two cases being resolved through cross-motions for summary judgment. Thus, there is a comprehensive factual record in both cases, in contrast to the typical situation in which a court is called upon to decide a question of standing solely or largely on the pleadings.

accounting method as "worldwide unitary income taxation," are nearly identical. Alcan alleges that, as a result of the method of taxation employed by California, Alcan "has been required to produce information regarding its non-United States activities," which "has resulted in an administrative and financial burden;" that, "unless restrained . . . [the Board] will continue to impose such worldwide unitary income taxation upon [Alcan] and its non United States subsidiaries;" that California's method of taxation "constitutes impermissible double taxation" in violation of the Foreign Commerce Clause; and that "using worldwide unitary income as a base for taxation, [sic] imposes a tax upon [Alcan] and its non-United States subsidiaries. . . ." JA 9-10. Similarly, Imperial alleges in its complaint that "[u]tilizing [Imperial's] 'worldwide unitary income' as a base for taxation imposes a California tax upon [Imperial] and its foreign (to the United States) subsidiaries;" that, as a result of the Board's method of computing taxes, Imperial "has been required to incur administrative and financial burdens and continues to be under such burdens;" and that the imposition by the Board of " 'worldwide unitary income taxation' upon [Imperial] and its subsidiaries . . . constitutes impermissible double taxation and interferes with the foreign commerce of the United States and the commerce of other nations in violation of the Foreign Commerce Clause. . . ." JA 19-20. Both of the parent companies pray that the Board be enjoined from assessing, levying or collecting any tax, the amount of which is determined, in whole or in part, by reference to the worldwide income of the plaintiffs and their subsidiaries, and that the Board's imposition of "worldwide unitary income taxation" be

declared void, unenforceable, and in violation of the Constitution.

B. The Alcan Group.

At all relevant times, Alcan and its subsidiaries (the "Alcan Group Companies") engaged in all phases of the aluminum business on an international scale. JA 64. Nearly 100 of Alcan's subsidiaries operated wholly outside the United States. *Ibid.* As previously noted, Alcan itself was a corporation organized and existing under the laws of Canada; it had its headquarters and principal place of business in Montreal, Quebec. *Ibid.* Neither Alcan nor any of its non-United States subsidiaries had a permanent place of business in the United States. JA 65.

Alcancorp, a second-tier subsidiary of Alcan, was organized under the laws of the State of Ohio, and had its principal place of business in Cleveland, Ohio. JA 65. This subsidiary engaged in the business of fabricating and selling aluminum products in the United States. JA 66. It was duly qualified to do business in California and in fact conducted certain of its business activities there, principally the operation of a large manufacturing facility in Riverside, California. JA 66-67.

Upon audit of Alcancorp's tax returns for the years 1965 and 1966, the Board determined that Alcancorp and its immediate parent, Aluminium Company of Canada, Limited ("Alcan Canada"), were engaged in a single unitary business. JA 68. Accordingly, the Board combined the income and activities of Alcancorp and Alcan Canada to determine the income of Alcancorp attributable to California, subsequently issuing notices of proposed assessments based on this unitary treatment. JA 69. Alcancorp, while not agreeing with the Board's right to combine the

activities of Alcancorp with Alcan Canada, or with other members of the corporate group headed by Alcan, requested that the notices of proposed assessment be modified to include all companies in the group. *Ibid.*

The Board has since audited, or is in the process of auditing, Alcancorp's returns for the years 1967 through 1974 and 1976 through 1981. JA 69; Alcan Stip., Exh. II (Supp. App., Item 3). Pursuant to these audits and the resultant administrative review process, the Board has determined that Alcancorp is part of a single unitary enterprise conducted by the Alcan Group Companies. *Ibid.* As a result, the Board has calculated Alcancorp's tax liability through 1978 on an apportioned share of the total business income of the unitary business conducted by all members of the group. *Ibid.* The apportionment fraction applied to such income has been calculated by reference to the ratio of Alcancorp's California property, payroll and sales to all of the property, payroll and sales of the unitary business conducted by the Alcan Group Companies. *Ibid.*

Alcancorp has paid the taxes so calculated for the years 1965 through 1974 and has pursued its administrative remedies with the Board. JA 76. It has also filed two actions for refund of these taxes in the California courts. *Ibid.*; Alcan Stip., Exhs. XIX-1 and 2 (Supp. App., Items 4 and 5). These actions are presently pending. *Ibid.*

All taxes assessed or proposed to be assessed by the Board are against Alcancorp. JA 99. The Board has not sent assessment notices to Alcan or any of the Alcan Group Companies which is not doing business in California. *Ibid.* The Board has not directed any correspondence to Alcan or any of the Alcan Group Companies which is not doing business in California. *Ibid.*

C. The Imperial Group.

Imperial is an English public limited company having its principal office and place of business in London, England. JA 38. It does not maintain a place of business in the United States, though it has an office in New York which is used by company officials when they are visiting the United States on business. *Ibid.*

Imperial owns, directly or indirectly, a majority interest in some 400 subsidiaries operating throughout the world. JA 39-40. The business activities of Imperial and its subsidiaries in Western Europe comprise 13 principal business groupings: agriculture, agrochemicals and colours, fibres, general chemicals, industrial explosives, oil, organics, paint, petrochemicals and plastics, pharmaceuticals, polyurethanes, plant protection, and speciality chemicals and materials. JA 38-39. The agrochemicals, pharmaceuticals and oil operations are conducted on a worldwide basis. *Ibid.*

Americas, the entity subject to California taxation, is a Delaware corporation. JA 41. It is the principal operating subsidiary of Imperial in the United States. *Ibid.* During the period 1971 through 1981, Americas conducted business in California through ownership and operation of a pharmaceutical manufacturing plant in Pasadena and other activities. *Ibid.*

Americas filed franchise tax returns with the Board for income years ending 1972 through 1981. JA 43. For those years in which Americas reported net income, it apportioned income to California on the basis of a three-factor formula, using California property, California payroll and California sales as the numerators and all property, payroll and sales of Americas as the denominators.

Ibid. Upon audit, the Board determined that Americas was part of a unitary enterprise conducted by all members of the group of companies headed by Imperial (the "ICI Group"). JA 46. Based on this determination, the Board recomputed Americas' net income subject to California tax, using as the apportionment base the worldwide income of the group. *Ibid.*

The Board issued Notices of Proposed Assessment against Americas in accordance with its determination that the domestic company was part of a unitary enterprise conducted by the ICI Group. JA 47-49. After the filing of a protest by Americas, the Board adjusted the assessments which had erroneously included certain items in the group income. JA 49-50. As a result of such adjustments, the Board's asserted liability for the year 1981 is less than Americas' self-assessed tax based on the supposition that only the activities of Americas constituted the conduct of a unitary business. JA 44-45, 47-48, 51.

Americas paid the additional assessments for 1972-1975, and timely filed claims for refund with the Board protesting the calculation of Americas' California tax on the basis that it is part of a unitary business conducted by the ICI Group. JA 53. Americas also has filed a protest of the proposed assessment, calculated on the same basis, for years 1976 through 1981. JA 53-54.

The Board has not directed any correspondence to Imperial or any member of the ICI Group other than Americas. JA 53. All taxes assessed or proposed to be assessed by the Board are against Americas. *Ibid.* The Board has not assessed or proposed to assess taxes against Imperial or any member of the ICI Group other than Americas. *Ibid.*

D. **Proceedings Below.**

Upon institution of the lawsuits by Alcan and Imperial, the Board filed motions to dismiss, asserting, inter alia, that the respective plaintiffs lacked standing to challenge the state tax treatment of their domestic subsidiaries. The District Court initially ruled in Alcan's favor on the standing question. JA 26-27. Acting upon a motion for relatedness filed by Imperial, the District Court thereafter reassigned the Imperial case to the judge handling the Alcan matter, and the Board withdrew its motion to dismiss Imperial's action. JA 30. Subsequently, in joint proceedings, each of the parties moved for summary judgment, with the Board again urging that requisite standing was lacking. On reconsideration of the standing question, the District Court held that respondents were subject to the general rule prohibiting shareholder suits to redress corporate injuries. It rejected the foreign parents' contentions that they suffer injuries distinct from those of their subsidiaries because California's method of taxation allegedly results in double taxation of their income and requires that they bear a substantial portion of the compliance costs. Accordingly, the District Court ordered that both actions be dismissed. Pet. App., A27.

Alcan and Imperial appealed to the Seventh Circuit Court of Appeals, which reversed the order of dismissal and remanded the matter for further proceedings. The Court of Appeals first stated that cases applying the shareholder standing rule fall into two categories: (1) those which bar standing to avoid the manipulation of diversity jurisdiction or a threatened interference with

corporate management, and hence "are animated by concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action," and (2) those which bar standing to avoid a multiplicity of suits, and hence are animated by mere "housekeeping concerns" of the federal judiciary. Pet. App., A10-11. The court then concluded that a denial of standing in the present cases would serve only the latter objectives, and, implicitly, that standing requirements are less stringent in this category of cases. See, e.g., Pet. App., at A11 (" . . . in addressing whether injuries to foreign parents are sufficiently direct to confer standing, we attend to which of the several aims of the shareholder standing 'rule' would be served by its invocation"). While apparently agreeing with the District Court that the alleged compliance costs and double taxation of income would not constitute direct injuries to the parent companies, see Pet. App., at A13-14, the court went on to find a "direct and independent injury" that had escaped even the attention of the respondent corporations. The Court of Appeals held that from the standpoint of foreign companies the unitary business/formula apportionment method of accounting employed by California diminishes the attractiveness of owning American subsidiaries as compared to conducting foreign commerce through contracts with independent companies; that the accounting method therefore burdens foreign companies' decisions to conduct foreign commerce through American subsidiaries; and that this burden on the decision-making of foreign companies is a direct and independent injury sufficient for standing purposes. Pet. App., at A15-17.

Turning next to the proscriptions of the Tax Injunction Act (28 U.S.C. § 1341), the Court of Appeals deemed

the Act to be inapplicable to the suits filed by Alcan and Imperial for declaratory and injunctive relief, stating that "the Act has not been construed so broadly as to bar a nontaxpayer (like the parent companies involved here) who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." Pet. App., at A18. The court then considered the principle of comity underlying the Act. It stated that the Act "left intact federal courts' 'discretionary power to grant or withhold relief so as to avoid needless obstruction of the domestic policy of the states' " and that, in some circumstances, "this discretion, guided by considerations of comity and federalism, may be exercised to bar suits against state tax assessments to which the Tax Injunction Act is inapplicable." Pet. App., at A18. It held, however, that "comity and federalism, weighty as these concerns are where the federal courts pass on the constitutionality of state tax legislation, cannot justify withholding federal jurisdiction from a party with no cause of action in state court to redress its own direct and independent injury." Pet. App., at A19.

SUMMARY OF ARGUMENT

The two questions presented in this matter are closely intertwined. In a previous case in which a foreign parent company unsuccessfully sought to challenge California's tax treatment of a domestic subsidiary, the District Court aptly stated that, in determining whether a parent company has standing to make such a challenge, the "salutary purposes [of the Tax Injunction Act] should be kept in mind." *Shell Petroleum, N.V. v. Graves*, 570 F. Supp. 58, 61 (N.D. Cal. 1983), aff'd, 709 F. 2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983). Similarly, when considering the applicability of the Tax Injunction Act in an action of this nature, the adequacy of alternative state remedies can fairly be determined only in light of the parent company's status as a corporate stockholder, particularly when the domestic subsidiary is wholly owned.

The coalescence here of the stockholder standing rule and the federal policy expressed in the Tax Injunction Act dictates that the propriety of the parent companies' suits to obtain injunctive relief against the California taxing authorities be judged against a stringent standard of justiciability. The initial error of the Court of Appeals is its conclusion to the contrary. The court has expressed the view that the issue of stockholder standing in state tax matters implicates only the "housekeeping concerns" of the federal judiciary, as opposed to "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action." Pet. App., at A10-A11. Such an approach is inconsistent with the long-established policy against federal intrusion in matters involving state taxation. See, e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 102 (1981). In addition, while the Court of Appeals has stated that historically one of the major purposes of the stockholder standing rule was to curb the use of stockholder suits to invoke federal diversity jurisdiction where a corporation itself could not, Pet. App., at A8, it has failed to recognize the parallelism in the present case. A federal suit brought by a sole stockholder to challenge state taxation when a suit by the corporate taxpayer would be barred by the Tax Injunction Act is just as objectionable as a collusive suit brought by one of several stockholders to obtain

access to a federal forum when the corporation itself could not satisfy diversity requirements.

The stockholder standing rule cannot be avoided by an allegation of injuries to the stockholder that are merely the indirect result of injuries to the corporation. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 486 487 (1930). A stockholder may bring an individual action, however, when he is injured directly and independently of the corporation. See, generally, 12B W. Fletcher, *Cyclopedia on the Law of Corporations* (Rev. Perm. ed. 1984), § 5911. In the courts below, Alcan and Imperial argued that their actions against the Board fall within this exception to the general rule due to their allegations that taxation of their domestic subsidiaries under the unitary business/formula apportionment method of accounting employed by California (1) results in double taxation of income in which the parent companies have an interest and (2) requires that they bear a substantial portion of the compliance costs. The Court of Appeals did not accept these arguments. Nonetheless, under its relaxed standard of justiciability, the court held that California's accounting method directly injures the parent companies by burdening their decisions to conduct foreign commerce through American subsidiaries.

The conclusion of the Court of Appeals that California's method of taxation burdens the decision-making of foreign companies appears to be based on the theory that when such companies choose to operate through American subsidiaries, and they conduct foreign operations at less cost than in California, a higher proportion of the unitary business' worldwide income will be attributed to California under the unitary scheme than would be the case "if [the parent company] engaged in precisely the

same foreign commerce through arm's length contracts with unaffiliated companies." Pet. App., at A16-17. The reasoning is faulty in two respects. Not only does it erroneously assume that foreign companies can conduct "precisely the same foreign commerce" through either an American subsidiary or an independent contractor, but it also assumes that foreign companies conducting business in California through unaffiliated companies would have taxable income determinable on a separate accounting basis. In fact, in the unlikely event that a foreign company were to incur *any* tax liability in California through its dealings with an independent contractor, that liability would be determined under the unitary apportionment method. From this standpoint, therefore, the unitary method cannot be viewed as a burden on a foreign company's decision to conduct foreign commerce in one form or another; that method would be used to determine *any* tax liability arising from unitary operations. The choice between conducting commerce through a subsidiary or an independent contractor would more likely entail a choice between some California tax or none at all. But even the Court of Appeals has not suggested that, because California would impose a tax on one of the group's companies in one instance but not the other, the imposition of *any* California tax is such a "burden" on a foreign company's decision-making as to give it standing to challenge the legality of that tax in federal court.

The Court of Appeals also has erred in concluding that the asserted burden on foreign companies' decision-making is a cognizable injury for standing purposes. A foreign company which can conduct "precisely the same foreign commerce" through either an American subsidiary or an independent contractor is free to select the

alternative which it considers most advantageous tax-wise. Furthermore, any injury to the parent companies in the present case (both of which already have made the choice to conduct foreign commerce through American subsidiaries) is merely the indirect result of the manner in which the Board has determined to calculate their subsidiaries' taxable income. The parties directly injured by the alleged wrongful acts of the Board are the corporate taxpayers. The fact that the foreign companies may be said to utilize their domestic subsidiaries as "instrumentalities of foreign commerce" is not substantive support for the Court of Appeals' holding that respondents suffer direct injuries that are independent of those to the domestic subsidiaries.

Respondents' own allegations of independent injury are without merit. The burden of double taxation, if any, falls on the corporate taxpayers which have been assessed the taxes that Alcan and Imperial claim are invalid under the Foreign Commerce Clause. The subsidiaries also bear the direct burden of any compliance costs. No information has been sought from the parent companies themselves.

The stockholder status of Alcan and Imperial also should serve to raise the bar of the Tax Injunction Act. As the sole stockholders of their respective subsidiaries, both of the parent companies effectively have alternative state remedies since they are in a position to ensure that the state remedies afforded to the actual taxpayers are pursued with vigor. In *South Carolina v. Regan*, 465 U.S. 369 (1984), this Court recognized, by way of dictum, that such practical considerations should govern the determination of whether a nontaxpayer has alternative remedies to seeking injunctive relief against taxing authorities. See

465 U.S., at 381, n. 19. There is also persuasive authority to the effect that a federal court should not entertain a stockholder's suit that is brought to circumvent the Anti-Injunction Act (26 U.S.C. § 7421(a)), which, in language analogous to that contained in the Tax Injunction Act, bars a suit "for the purpose of restraining the assessment or collection of any [federal] tax."

Both Alcan and Imperial have argued at one time or another that the state remedies available to their domestic subsidiaries are inadequate, insofar as the parent companies are concerned, because the subsidiaries would be unable to raise the constitutional claims that are "peculiar" to the parents. The parent companies, however, do not have peculiar rights under the Foreign Commerce Clause, see, e.g., *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-128 (1978), and thus do not have any peculiar claims to assert. The taxpayer-subsidiaries, on the other hand, as the parties directly concerned with the California tax assessments, clearly would have the right in the state courts to raise any and all constitutional objections to the taxes they are required to pay.

Finally, if it should be determined that the Tax Injunction Act does not bar a stockholder's suit which seeks to challenge state taxation of a corporate taxpayer, there is an obvious gap in the law. This gap should be closed by a reaffirmation of the principle of comity underlying the Act. It makes no sense that the "salutary purposes" of the Tax Injunction Act should fall by the wayside simply because an action is brought in the name of a sole stockholder rather than in the name of the corporate taxpayer.

ARGUMENT

I

THE HOLDING BELOW THAT FOREIGN PARENT COMPANIES HAVE STANDING TO CHALLENGE THE STATE TAXATION OF THEIR DOMESTIC SUBSIDIARIES IS AN ILL-FOUNDED DEPARTURE FROM TRADITIONAL STANDING RULES THAT WOULD RESULT IN UNPRECEDENTED FEDERAL INTRUSION IN STATE TAX MATTERS.

A. A stockholder's effort to obtain federal relief against state taxation of a corporate taxpayer dictates adherence to a stringent standard of justiciability.

This Court has long recognized "the important and sensitive nature of state tax systems and the need for federal court restraint when deciding cases that affect such systems." *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100, 102 (1981). Thus, even prior to the enactment of the Tax Injunction Act (28 U.S.C. § 1341), the Court espoused a principle of equitable restraint in state tax matters. As it explained in *Matthews v. Rodgers*, 284 U.S. 521, 525 (1934):

> "The reason for this guiding principle is of peculiar force in cases where the suit . . . is brought to enjoin the collection of a state tax in courts of a different, though paramount sovereignty. The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it."

The Tax Injunction Act reinforces this principle of noninterference with state tax administration, but does not supplant it. On the contrary, this Court has held that the principle of comity underlying the Act is so compelling as

to preclude federal intrusion in state tax matters even in situations not specifically covered by the Act. See *Fair Assessment in Real Estate v. McNary, supra* (holding that the principle of comity precludes a suit for monetary damages under 42 U.S.C. § 1983); see also *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293 (1943).

The Court of Appeals' whole approach to the standing issue in the present matter is inconsistent with this line of authority. When addressing the issue of standing, the Court disregards the fact that these stockholder suits seek declaratory and injunctive relief against state taxing authorities. Instead the Court says that since the suits do not involve a manipulation of diversity jurisdiction or a threat to corporate management, the stockholders' standing only implicates the court's "housekeeping concerns," as opposed to "concerns about the limits on judicial power and the appropriateness of a particular plaintiff bringing a particular action." Pet. App., at A10-A11. Only *after* the court concludes that the Board has invoked the stockholder standing rule in an area "where its underpinnings are weakest" (Pet. App., at A17), and only *after* the Court concludes that "housekeeping concerns" do not warrant a denial of standing, does the Court proceed to recognize "that 'the principle of comity militates in favor of a stringent standard of justiciability in cases that threaten to interfere with state taxes.' " Pet. App., at 19. The Board submits that this is a backward approach to the standing issue which is clearly erroneous. A shareholder's suit brought to challenge state taxation of a

corporate taxpayer belongs at the top of the Court of Appeals' totem pole, not at the bottom.[4]

Furthermore, the Court of Appeals' analysis of the stockholder standing rule is historically inaccurate. Even the so-called "traditional limitations on shareholder standing" which the court places at the top of its totem pole cannot properly be characterized as merely "judge-made restrictions on the availability of the federal courts." Pet. App., at A10. In fact, the rule predates the federal court system. As is evident from this Court's decision in *Hawes v. City of Oakland*, 104 U.S. 450 (1881), a case cited by the Court of Appeals, the rule goes back to

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[4] The Court of Appeals states in its opinion that "The FTB does not seriously contest plaintiffs' claims that their interest in challenging the California franchise tax satisfies the case or controversy requirement." Pet. App., at A5. On the contrary, the Board has never accepted the proposition that a shareholder seeking to redress a corporate injury has standing in the constitutional sense. Article III "requires the party who invokes the Court's authority to 'show that he *personally* has suffered some actual or threatened injury.' " *Valley Forge College v. Americans United*, 454 U.S. 464, 472 (1982); emphasis added. The legal basis for the general rule that only a corporation and not its shareholders can complain of an injury or wrong done to the corporation is that a stockholder is not personally injured by a wrong done to the corporation; his rights are derivative. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 487 (1930). Thus, although the cases dealing with stockholder standing generally have constituted a line of authority separate from that dealing with standing under Article III (see, however, *EMI Ltd. v. Bennett*, 738 F. 2d 994, 996 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984)), it remains open to question whether a sole or controlling shareholder's ownership interest in a corporation is sufficient by itself to satisfy the "injury in fact" requirement of Article III. In any event, even if the "injury in fact" requirement is satisfied, it is clear that such a stockholder may pursue an individual action only upon the showing of a direct injury which is independent of any injury to the corporation. See, *supra*, at 22-25.

the English common law and is based on the fact that a corporation is an entity separate from its stockholders. *Id.*, at 455. The *Hawes* case itself involved the misuse of an exception to the rule prohibiting a stockholder's action to redress a corporate injury, namely, the maintenance in equity of a so-called derivative suit. The Court was particularly concerned with increasingly common situations in which corporations, "instead of resorting to the State courts, which are their natural, their lawful, and their appropriate forum" (*id.*, at 452) would collude with an out-of-state stockholder in order to satisfy the requirements of diversity jurisdiction where a federal action was not otherwise available. *Id.*, at 452-453. See also *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529-533 (1983).

The Court of Appeals has missed the parallelism between a collusive suit brought by one of several stockholders to enable a corporation to obtain access to a federal forum, and a suit brought by a sole stockholder of a corporation to accomplish the same objective. Due to the proscriptions of the Tax Injunction Act, neither of the actual taxpayers in the present matter can seek declaratory and injunctive relief against the California tax assessments in federal court. At the same time, though the Court of Appeals is reluctant to concede the point (see Pet. App., at A4-A5), it should be evident that the actual taxpayers can voice any and all Foreign Commerce Clause objections to the tax assessments in the state courts. Under these circumstances, the federal suits brought in the names of the sole stockholders serve no purpose other than to provide the corporate taxpayers with a federal forum – a forum to which they would otherwise not be entitled.

B. The parent companies have no standing to litigate the state tax treatment of their domestic subsidiaries absent a showing that they suffer some injury which is truly distinct from, and not merely the indirect result of, injuries to the subsidiaries.

The principle that only a corporation and not its stockholders can complain of an injury or wrong done to the corporation has been honored by the federal judiciary since the early days of its history. See, e.g., *Davenport v. Dows*, 85 U.S. 626 (1874); *Hawes v. Oakland*, 104 U.S. 450 (1882); *Huntington v. Palmer*, 104 U.S. 482 (1882); see also *Forbes v. Memphis*, 9 F. Cases 408 (F. Case No. 4,926) (1872); *Langdon v. Hillside Iron & Coal Co.*, 41 F. 609 (1890).[5] The rule has just as much force today as it ever did. If the cause of action is the corporation's, the corporation is a necessary party, and relief must be sought either directly by the corporation or through a derivative action brought on its behalf. See, e.g., *Ross v. Berhard*, 396 U.S. 531, 538 (1970); *Sax v. World Wide Press*, 809 F. 2d 610, 613-614 (9th Cir. 1987); *Gaff v. Federal Deposit Ins. Corp.*, 814 F. 2d 311, 315, vacated in part, 828 F. 2d 1145 (6th Cir. 1987); *Twohy v. First Nat. Bank of Chicago*, 758 F. 2d 1185, 1194 (7th Cir. 1985).

The rule that a stockholder may not bring suit to redress a corporate injury cannot be avoided by an allegation of injuries to the stockholder which are merely the

[5] Both *Davenport* and *Huntington* involved an action by a stockholder seeking injunctive relief against the assertion of taxes against the corporation in which he held an interest. In *Davenport*, this Court held that a demurrer to the complaint should have been sustained since the corporation itself was not made a party to the suit. In *Huntington*, it held that a demurrer to the complaint had been properly sustained since the stockholder had not satisfied the requirements of a derivative suit.

indirect result of wrongs to the corporation. *Pittsburgh & W. Va. Ry. v. U.S.*, 281 U.S. 479, 486-487 (1930). However, a stockholder may sue to redress direct injuries to himself. Thus, exceptions to the rule are recognized in two situations: (1) where there is a special duty owed to the stockholder personally, "as where the action is based on a contract to which he is a party, or on a right belonging severally to him, or on a fraud affecting him directly;" and (2) where the stockholder suffers an injury separate and distinct from any injury suffered by other stockholders or the corporation itself. 12B W. Fletcher, *Cyclopedia on the Law of Corporations*, § 5911 (Rev. Perm. ed. 1984) (footnotes omitted).

"In cases of the first sort, the complaining shareholder may sue as an individual only because he stands, and has been injured in his relationship to the corporation, in a capacity other than that of a shareholder." *Cowin v. Bresler*, 741 F. 2d 410, 415 (D.C. Cir. 1984). Illustrative decisions applying this exception include *Sedco International, S.A. v. Cory*, 522 F. Supp. 254 (S.D. Iowa 1981), aff'd, 683 F. 2d 1201 (8th Cir. 1982), cert. den., 459 U.S. 1017 (1982) (stockholder injured in his capacity as creditor of corporation); *Empire Life Insurance Co. v. Valdak Corp.*, 468 F. 2d 330 (5th Cir. 1972) (stockholder injured as pledgor in loan transaction); *Davis v. United States Gypsum Co.*, 451 F. 2d 659 (3rd Cir. 1971) (stockholder injured as guarantor of corporate notes). The exception "does not arise merely because the acts complained of resulted in damage both to the corporation and to the stockholder, but is confined to cases where the wrong itself amounts to a breach of duty owed to the stockholder personally." *Schaffer v. Universal Rundle Corporation*, 397 F. 2d 893, 896 (5th Cir. 1968).

Under the second exception to the stockholder standing rule, an individual action may be brought where wrongs are inflicted upon a stockholder alone or upon certain stockholders and not the corporation. *Cowin v. Bresler, supra*, at 415. As noted in *Cowin*, this type of case is illustrated by a suit complaining of wrongful withholding of dividends. "Because dividends are an incident of stock ownership, an action to compel the payment of dividends withheld will not inure to the benefit of the corporation; the shareholders alone will gain by a judgment in their favor and, therefore, each shareholder may sue for his own account." *Ibid*. See also *American Power & Light Co. v. S.E.C.*, 325 U.S. 385, 388-391 (1945) (sole stockholder was "person aggrieved" by an order of the Securities and Exchange Commission requiring that an item in the corporation's surplus account be transferred to another account where the item would be unavailable for the payment of dividends).

It is clear that, for either exception to apply, there must be an invasion of some independent right held by the stockholder. The alleged harm must be direct, not indirect. Cf., *Associated General Contractors v. Carpenters*, 459 U.S. 519 (1983) (holding that a labor union was not a "person . . . injured" within the meaning of section 4 of the Clayton Act since any injuries to the union were only the indirect result of injuries to third parties); see, in particular, n. 25 and accompanying discussion on common law damages. Accordingly, it is well settled that a stockholder may not bring an individual action to redress corporate grievances even though he may be economically affected by a wrong to the corporation. See *Pittsburgh & W. Va. Ry. v. U.S., supra*; see also *Sax v. World Wide Press, Inc., supra* (loss of interest income on stock investment); *Gaff v. Federal Deposit Ins. Corp., supra* (diminution in value of stock); *Rand v. Anaconda-Ericsson, Inc.*, 794 F. 2d 843 (2d Cir. 1986), cert. den., 479 U.S. 987 (1986) (same); *Warren v. Manufacturers National Bank of Detroit*, 759 F. 2d 542 (6th Cir. 1985) (same); *Erlich v. Glasner*, 418 F. 2d 226 (9th Cir. 1969) (injuries to business and "right and ability to earn a livelihood"); *Schaffer v. Universal Rundle Corporation, supra* (damage to "good will and reputation" of sole stockholder).

On three previous occasions, these principles have been applied in actions brought by a foreign company to challenge California's tax treatment of its domestic subsidiary, and in each case it was held that the foreign company lacked requisite standing because any injuries to that company were merely the indirect result of actions taken against the subsidiary. See *Shell Petroleum, N.V. v. Graves*, 709 F. 2d 593 (9th Cir. 1983), cert. den., 464 U.S. 1012 (1983); *EMI Ltd. v. Bennett*, 738 F. 2d 994 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984); *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F. 2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984). Aside from certain treaty-based claims made in *Shell* and *EMI*, the alleged injuries in each of these cases were substantially identical to those alleged by Alcan and Imperial in the present cases. Indeed, one of the previous cases was an unsuccessful attempt by Alcan to obtain the same relief against the Board that it now seeks in the federal court in Illinois.[6]

[6] The Board raised the issue of collateral estoppel before the District Court in Illinois, but that issue was never reached by the court, which dismissed Alcan's action on standing grounds. Consequently, the Board did not address the issue of collateral estoppel in the appeal before the Seventh Circuit.

C. The Court of Appeals has given no valid basis for concluding that the parent companies suffer direct injuries that are independent of those to the corporate taxpayers.

1. The Court of Appeals erroneously concluded that the unitary method of taxation burdens the decision-making of foreign companies.

Alcan and Imperial argued in the courts below that the requirement of a direct and independent injury was satisfied by their allegations that the application of California's unitary method of taxation to their domestic subsidiaries results in double taxation of the parents' income (as well as other income in which the parents have an interest) and requires the parents to bear substantial compliance costs. As previously noted, the Court of Appeals did not accept these arguments. It did, however, discover another purported "injury" that was not even suggested by respondents: a burden on the foreign companies' decisions to conduct business through American subsidiaries due to the unitary method's potential "to penalize foreign ownership of American assets." Pet. App., at 15.[7]

The Court of Appeals said that foreign companies seeking to sell or purchase products or services in California choose between conducting business through dealings with American subsidiaries or through contracts

[7] Not only did the respondents fail to raise this argument, but Alcan suggested the reverse: that the unitary method "as applied to foreign parents [sic] has penalized *foreign* activities which increase productivity or develop cheap and abundant resources." Brief of Appellant (Alcan Aluminium Ltd.), at 36; emphasis added.

with unrelated companies.[8] It then appeared to reason that when such companies choose to operate through American subsidiaries, and they conduct foreign business operations at less cost than in California, a higher proportion of the unitary business' worldwide earnings will be attributed to California than would be the case if the foreign companies engaged in precisely the same foreign commerce in California through arm's length contracts with unaffiliated companies. Pet. App., at A15-16. It follows, the court concluded, that the unitary tax diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies, creating a burden on foreign companies' decisions to conduct business through American subsidiaries.

The reasoning of the Court of Appeals contains two major flaws. First, the Court of Appeals has erroneously assumed that if a foreign company were to do business in California through "arm's length contracts with unaffiliated companies," it would have taxable income determinable on a separate accounting basis rather than under the unitary method.[9] On the contrary, in the unlikely event

[8] The court overlooked the fact that foreign companies desiring to conduct business in the United States have a third choice: the conduct of business through branch operations. See, e.g., *Bass, etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924) (upholding use of formula apportionment to determine locally taxable income of United Kingdom corporation with branch operations in New York).

[9] The Court of Appeals speaks in terms of the unitary method attributing to California a higher "proportion . . . of worldwide earnings" than would be attributed to California if

(Continued on following page)

that a foreign company were to operate in California through an unaffiliated corporation in such a way as to incur *any* tax liability, that liability would be determined under the unitary apportionment method.[10] If, instead, the foreign company chose to operate in California through a branch of its own corporation, the taxable income of the foreign company would also be determined

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a foreign company conducted its commerce through unaffiliated companies. Thus, the court is clearly under the impression that *some* taxable income of the worldwide unitary business, as opposed to a zero amount of income, would be attributed to the state even in the latter instance. In fact, whether the parent dealt directly with the unaffiliated company or had its American subsidiary do so, if only the unaffiliated company and not the parent or its subsidiary were doing any business in California, California would attribute *none* of the worldwide unitary business income to California since neither parent nor subsidiary would be a California taxpayer under these circumstances.

[10] In its reply to the Board's petition for rehearing in the Court of Appeals, Alcan took this to mean that the Board asserts "it can combine for unitary purposes two companies that are unaffiliated and are dealing at arms [sic] length." Reply to Petition for Rehearing (Alcan Aluminium Limited), at 1-2. That, of course, is incorrect. The point is simply this: If a foreign company engaged in a unitary enterprise were doing business in California through an unaffiliated company in such a manner as to give rise to *any* tax liability on the part of the foreign company, the unitary character of the business would require that the foreign company's tax liability be determined on a formula apportionment basis. This would entail a combined report of only the operations carried on by the *unitary* enterprise within and without the state, not a combined report of the unitary operations and the independent operations of the unaffiliated company.

under the unitary apportionment method. And, finally, if the foreign company were to operate through an American subsidiary, the taxable income of that subsidiary would be determined under the unitary apportionment method. Given these circumstances, the unitary method cannot be viewed as a burden on the foreign company's decision to conduct foreign commerce in one form or another. The unitary method would be used to determine taxable income attributable to California regardless of the form chosen.

In holding that respondents have requisite standing in this matter, the Court of Appeals has also assumed that foreign companies such as Alcan and Imperial have the option of conducting "precisely the same foreign commerce" through either American subsidiaries or independent contractors. This is difficult to imagine. California has not been a mere marketplace for the goods produced by the multinational enterprises headed by Alcan and Imperial. The principal activity of Alcan's subsidiary in California during all but one of the 14 years covered by the challenged tax assessments (1965-1978) consisted of the operation of a large manufacturing facility. JA 66-67. Similarly, Imperial's subsidiary operates manufacturing and research facilities in California. JA 42-43. It is inconceivable that either Alcan or Imperial could conduct "precisely the same foreign commerce" through unaffiliated companies.

Once again, therefore, it is unrealistic for the Court of Appeals to conclude that California's use of the unitary method of taxation in the present matter "diminishes the attractiveness of owning American subsidiaries in comparison with entering into contracts with independent companies as a means of engaging in foreign commerce."

Pet. App., at A15. Such a comparative situation does not exist here. In order to participate in the American economy to the extent they do, Alcan and Imperial must operate either through branches or American subsidiaries.[11] What they insist, however, is that the income attributed to the California segment of the unitary business be determined under the separate accounting/arm's length method of taxation. They have pitted this accounting method against the unitary method, not the use of American subsidiaries against the use of independent contractors.

2. Even if the foreign parents were faced with the choice envisioned by the Court of Appeals, such a "burden" on their decision-making would not constitute a cognizable injury for standing purposes.

As indicated above, the Court of Appeals has apparently assumed that if a foreign company which is part of a unitary business were to engage in commerce in California through contracts with an unaffiliated company, at least some of the income of the unitary business would be attributed to California. Thus, the Court has not gone so far as to suggest that since a foreign company might be able to devise a way to conduct its foreign commerce through an unaffiliated company totally free of California taxes, the imposition of *any* tax against its American

[11] This was explicitly recognized by Imperial in its opening brief in the Court of Appeals, in which it stated: "Without the existence of Americas, Imperial's considerable commerce with the United States could not exist." Brief of Plaintiff-Appellant Imperial Chemical Industries PLC, at 21.

subsidiary is such a burden on a foreign company's decision-making as give that company standing to challenge *any* California tax in the federal courts. It has stopped just short of that, however.

In effect the Court of Appeals has held that, everything else being equal, a foreign company should not be faced with a state tax law which would tend to discourage the selection of one form of doing business over another. In other words, its underlying thesis seems to be that the potential tax liability arising from the conduct of foreign commerce should be the same regardless of the form in which the commerce is conducted. It is a fact of life, however, that tax consequences often vary, depending upon the form of doing business, the form of a particular business transaction, etc.

It is difficult to understand how the resulting "burden" on a company's decision-making can be regarded as a cognizable injury. In the present case, for example, how are the parent companies truly injured if, as assumed by the Court of Appeals, they can conduct "precisely the same foreign commerce" through either American subsidiaries or independent contractors? They are entirely free to select the alternative which, in their view, will have the most favorable tax consequences. It is illogical to conclude that they suffer a cognizable injury simply because they are put to a choice and may *prefer* to do business in a different form.

In concluding otherwise, the Court of Appeals has also failed to consider the ramifications of its holding that a burden on foreign companies' decision-making will suffice for standing purposes. If indeed such a burden constitutes a cognizable injury, then presumably the injury is at its peak during the decision-making process.

This, in turn, suggests that a foreign company would have standing to challenge the taxing procedures of a state before it ever extended its commerce to that state, i.e., before it made the crucial decision to conduct such commerce through an independent contractor, a branch operation, or a domestic subsidiary. This raises the specter of state taxes being challenged in federal courts not only by nontaxpayers, but by nontaxpayers having no relationship at all, either direct or indirect, with the taxing state.

Finally, in holding that California's method of taxation has somehow burdened the decision-making of Alcan and Imperial (after the barn door has been closed, so to speak), the Court of Appeals has improperly focused on the merits of the constitutional claims they seek to litigate. A principal contention of respondents on the merits of the controversy is that, when applied to domestic corporations with foreign parents, California's unitary method of taxation violates the "one voice" standard set forth in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1978). In particular, they have pointed to foreign objections to this method of taxation and to the possibility of foreign retaliation. The Court of Appeals has confused these constitutional claims with the essential question of standing: whether the parent-stockholders, or the corporate taxpayers, are the proper parties to litigate the constitutional claims.

The Court of Appeals has stated, for example, that "[t]o the extent that California's franchise tax burdens foreign companies' decisions to conduct business through subsidiaries operating in California, it threatens to offend this country's trading partners. . . ." Pet. App., at A16. It has also stated that "It is important that these injuries [to

Alcan and Imperial] . . . have fueled a simmering trade controversy which has raised concerns about foreign retaliation and the country's ability to speak with one voice on matters of foreign commerce. . . ." *Id.*, at A17. And at footnote 10 of its opinion, the Court has reasoned that the unitary method "implicates . . . concerns about foreign retaliation" because it "has the potential to shift a higher proportion of the corporate tax burden onto companies that are affiliated with foreign operations."[12] It continues:

> "Evaluation of the constitutional significance of this threat in the particular circumstances presented by California's unitary tax must await the district court's assessment of the merits of this appeal. *We decide only that the potential for constitutionally significant offense is sufficient to create standing.*" *Id.*, at A16; emphasis added.

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[12] This potential also exists, of course, in the case of a multinational enterprise headed by a domestic company. It is also unclear what the Court of Appeals means by its statement that, "The potential for the unitary tax to penalize foreign ownership of American assets distinguishes the unitary tax from environment or safety regulations that might cause comparable increases in the cost of doing business in California, but would presumably affect foreign and domestically owned operations fairly equally." Pet. App., at A15. California's tax treatment of foreign and domestically owned operations is the same. Furthermore, assuming arguendo that a foreign company could reduce the cost of doing business in California by choosing to operate solely through independent contractors, thus eliminating the use of foreign factors in California's tax computations, exactly the same choice (or in the Court's analysis, exactly the same burden) would be available to domestic parents engaged in foreign commerce by means of a worldwide unitary business.

The Court of Appeals has held, in short, that since there may be some merit to the Foreign Commerce Clause claims made by Alcan and Imperial, they have the standing to litigate those claims. This Court has repeatedly observed, however, that "standing in no way depends on the merits of the plaintiff's contention that particular conduct is illegal. . . ." *Warth v. Seldin*, 422 U.S. 490, 500 (1975); see also *Flast v. Cohen*, 392 U.S. 83, 99 (1968); *Simon v. Eastern Ky. Welfare Rights Organization*, 426 U.S. 26, 37-38 (1976); *Valley Forge College v. Americans United*, 454 U.S. 464, 476 (1982).

3. The purported injury to the parent companies is neither "direct" nor "independent" of their status as corporate stockholders.

Prudential considerations in general, see, e.g., *Allen v. Wright*, 468 U.S. 737, 751 (1984), and the shareholder standing rule in particular ordinarily prohibit a party from litigating the legal rights of another. The legal right at issue in the present matter is the right of the corporate taxpayers to have their tax liability determined in a lawful manner – i.e., in a manner which does not violate the Foreign Commerce Clause. Whether the constitutional issue is litigated in suits for refund brought by the corporate taxpayers in the state courts, or whether their foreign parents are permitted to litigate the issue in federal court, the issue remains the same: Do the taxes assessed against the corporate taxpayers interfere with Congress' power to regulate foreign commerce? Thus, the standing question essentially is whether the parent companies may challenge the constitutionality of tax assessments issued against taxpayer-subsidiaries which are perfectly capable of pursuing the same constitutional claims.

The Court of Appeals has concluded that the foreign parents are injured in such a way as to have standing to litigate their subsidiaries' tax liability. As discussed above, the perceived injury to the parents is tenuous at best. In addition, however, the Court of Appeals has failed to offer any reasoned explanation for treating the perceived injury to the parent companies as either a "direct" injury or as an injury "independent" of their stockholder status.

If the tax liability of a corporate taxpayer is determined in a manner which violates the Foreign Commerce Clause, it seems self-evident that the party *directly* injured by such a tax determination is the corporate taxpayer against which the unlawful taxes are assessed. Conversely, any injuries to a parent-stockholder in such an instance are necessarily *indirect* since they result from the allegedly unlawful taxes assessed against the corporate taxpayer. The Court of Appeals has not explained its logic for concluding otherwise.

The Court does offer some explanation for treating the perceived injury as one not affecting the foreign companies only in their capacity as stockholders, but its explanation is hardly satisfactory. The Court says that the foreign parents not only own the subsidiaries; they own them "as instrumentalities of the foreign commerce of [the] parents." Pet. App., at A15. But why is this a fact of magical proportions? Every wholly-owned subsidiary can be viewed as an instrumentality by which the parent conducts one type of commerce or another – intrastate, interstate or foreign. The fact that a foreign company utilizes an American subsidiary as an instrumentality of foreign commerce should not, therefore, be considered as creating some sort of special relationship between the two for standing purposes.

The decision of the Court of Appeals to the contrary raises, of course, still other questions. How far does its reasoning go? Is federal standing to litigate state tax matters to be accorded only to foreign companies which own American subsidiaries? If so, what is the justification for differential treatment of domestic companies which utilize various subsidiaries as "instrumentalities" of interstate commerce? If federal standing is not to be so limited, will the federal courts be deluged with suits filed by domestic companies which are dissatisfied with the state tax treatment of their subsidiaries? Meanwhile, what happens to the spirit, if not the letter, of the Tax Injunction Act?

D. The specific claims of independent injury actually asserted by the parent companies in the courts below were properly rejected by the Court of Appeals.

It has been stipulated in the two cases that (1) all taxes are or will be assessed against the domestic subsidiaries, and (2) all informational requests have been directed only to the domestic subsidiaries. JA 53, 99. Alcan and Imperial nevertheless have claimed that they suffer injuries independent of those to their domestic subsidiaries because they must bear the burdens of double taxation and excessive compliance costs allegedly arising from California's use of formula apportionment in calculating their subsidiaries' taxable income. All of the previous cases which have held that foreign parents lack standing to challenge California's method of taxation as applied to their domestic subsidiaries have considered and rejected identical claims of independent injury. See, *infra*, at 25. The Court of Appeals properly rejected the same claims in the cases at hand.

One aspect of the double taxation argument is the suggestion by Alcan and Imperial that California is actually taxing the income of the foreign parents because their income is taken into account in the apportionment formula. This contention, which is the classic argument against the use of formula apportionment, has, of course, been soundly rejected by this Court on numerous occasions. Addressing a similar claim just last year, the Court stated:

> "But income that is included in the preapportioned tax base is not, by virtue of that inclusion, taxed by the State. . . .As our Commerce Clause analysis of apportionment formulas has made clear, the inclusion of income in the preapportioned tax base of a state apportionment formula does not amount to extraterritorial taxation." *Shell Oil Company v. Iowa Dept. of Revenue*, ___ U.S. ___, 109 S. Ct. 278, 284, 102 L. Ed. 2d 186, 199 (1988).

The notion that formula apportionment and extraterritorial taxation go hand-in-hand has no greater credibility in the standing context than it has in an attack on the use of formula apportionment generally.

Furthermore, Alcan and Imperial have never explained why the taxes imposed on Alcancorp and Americas would directly injure the parent companies even if the taxes were *not* measured solely by the subsidiaries' income. The tax assessments have been issued only against the California taxpayers, and only the California taxpayers are held accountable to California. Obviously, if the asserted taxes are measured in part by income earned and taxed elsewhere, it is the corporate taxpayers which must bear the burden of the resulting double taxation. At the most, Alcan and Imperial would be injured only to the extent that the taxes imposed on Alcancorp and Imperial (double or otherwise) adversely affect the value of the parents' stockholdings in those subsidiaries.

Beyond question, such an injury is insufficient for standing purposes. See, *infra*, at 24-25.

Imperial has sought to bring the claim of double taxation closer to home by also arguing that, because the taxing authorities of the United Kingdom consider the California taxes to be partially measured by income not having a source in California, Imperial cannot take full advantage of a credit allowed under U.K. law. This credit relates to foreign taxes paid on earnings which are the source of dividends paid to a U.K. company. See Imperial Stip., Exh. 19. In the present case, however, no dividends have in fact been paid by Imperial's domestic subsidiary during any of the years in question. *Ibid.* Accordingly, the asserted injury to Imperial is purely hypothetical. Moreover, even if dividends had been paid to the parent company, and even if the U.K. credit had been affected by the California taxes, Imperial still would suffer only an *indirect* injury as a result of the alleged wrongful act of California – namely, California's imposition of an excessive tax upon Imperial's subsidiary. There would be no breach of a duty owed by California to Imperial in such a situation.

The further claim that the foreign parents are forced to bear the burden of compliance costs is also without merit. The parents have not been asked to do anything. Informational requests made by the Board during the audit process have been directed only to Alcancorp and Americas. No demands have been made on Alcan and Imperial, and clearly both have been at liberty to decline any requests for information which may have been directed to them by their subsidiaries. The situation is the same as that presented in *EMI Ltd. v. Bennett, supra,* 738 F. 2d, at 996, where the court stated:

"The FTB is making demands for information only from Capitol. If Capitol fails to produce the information because of EMI's recalcitrance the result will be, at worst, either an increase in Capitol's tax liability or a tax penalty. Whether through the imposition on Capitol of taxes or the increase in taxes because of Capitol's failure to produce information, EMI's only possible injury is the diminution in the value of its holdings in Capitol."

The reasoning of the *EMI* court applies with equal force to respondents' argument that, unless their subsidiaries are to be at the mercy of the California taxing authorities, the parents must establish elaborate systems of accounting to determine the correct California tax liability. What Alcan and Imperial actually are complaining about is the expense of gathering information which *they* deem essential to a fairer calculation of the taxes assessed against their subsidiaries. This again would be an assumed burden undertaken to preserve the value of their stockholdings, not a burden imposed upon them by the taxing authorities.[13]

There remains one further argument advanced by Imperial. Citing *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1978), Imperial has contended, in effect, that a foreign company should have standing to raise constitutional objections to tax assessments against its domestic subsidiary even in the absence of an independent injury.

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[13] The extent to which *any* additional information furnished by the parent companies would substantially alter the amount of taxes assessed is itself subject to dispute. Much of the information utilized in making the assessments against Alcancorp and Americas is already available in published form. See JA 51-52, 70-71.

It has reasoned that the property tax challenged by the foreign corporation in *Japan Line* was imposed upon the containers, not upon the foreign owner of the containers. By the same token, according to Imperial, it should have standing to challenge the constitutionality of a tax imposed upon its subsidiary, which, like the containers in *Japan Line*, are instrumentalities of foreign commerce. The situation is not, of course, analogous. Obviously, in *Japan Line* the containers themselves were not the taxpayers; the only taxpayer was the foreign owner of the containers. In the present cases, the reverse is true; the tax assessments have been directed to the two domestic subsidiaries, and they, not their foreign owners, are the California taxpayers.[14]

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[14] Imperial has previously asserted that the Board, for purposes other than standing, treats all corporations within the unitary group as one "taxpayer." This is incorrect. The apportionment provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA) are incorporated in the California Revenue and Taxation Code at sections 25120 through 25139. Under California law, these provisions apply both to a unitary business conducted by a single corporation and to a unitary business conducted in multi-corporate form. In some of the apportionment provisions the term "taxpayer" is used to refer to the unitary business as a whole. For example, section 25134 defines the sales factor as "a fraction, the numerator of which is the total sales of the taxpayer in this state, *and the denominator of which is the total sales of the taxpayer everywhere during the income year*." (Emphasis added.) When this provision is applied to a unitary business conducted by two or more corporations, the term "taxpayer" in the second clause refers to all components of the unitary business, but the same term in the first clause refers only to the entity doing business in California. The franchise tax is imposed only upon the "corporation doing business within the limits of [the] state. . . ." Cal. Rev. & Tax. Code § 23151. Accordingly, only the corporation doing business in California is the California "taxpayer" in the traditional sense of the party actually subject to state taxation.

II

ENTERTAINMENT OF THE FEDERAL ACTIONS FILED BY THE PARENT COMPANIES CANNOT BE RECONCILED WITH THE PROSCRIPTIONS OF THE TAX INJUNCTION ACT AND ITS UNDERLYING PRINCIPLE OF COMITY.

A. Introductory Statement.

In their briefs in opposition to the Board's petition for review of the Court of Appeals' decision, both Alcan and Imperial asserted that the Tax Injunction Act (28 U.S.C. § 1341) does not present a meaningful issue in this matter. The applicability of the Act, on the contrary, is very much an issue even if it should be determined or assumed that Alcan and Imperial otherwise satisfy standing requirements.

Section 1341 provides:

> "The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State."

It is well established that the statute is an explicit Congressional limitation on the jurisdiction of the federal courts in the area of state taxation. As this Court stated in *Rosewell v. LaSalle National Bank*, 450 U.S. 503, 522 (1981):

> "The statute 'has its roots in equity practice, in principles of federalism, and in recognition of the imperative need of a State to administer its own fiscal operations.' *Tully v. Griffin, Inc.*, 429 U.S. (68), at 73. This last consideration was the principal motivating force behind the Act; this legislation was first and foremost a vehicle to limit drastically federal district court jurisdiction to interfere with so important a local concern as the collection of taxes."

Thus, the Tax Injunction Act generally prohibits federal courts from granting injunctive relief in cases involving state tax administration; such relief is permitted only

in exceptional circumstances where the state court remedy is not "plain, speedy and efficient." *Id.*, at 512. The same rule is applied to requests for declaratory relief. *California v. Grace Brethren Church*, 457 U.S. 393, 408 (1982).

The Court of Appeals decided in the present matter that the sole stockholder of a corporation is not barred by the Act from bringing a federal action to challenge state taxes levied against that corporation, even though, as the sole corporate stockholder, it is capable of pursuing its constitutional objections to the taxes through the state remedies afforded to the corporation. As will be explained below, this ruling not only defies reason but is in conflict with past authority.

B. For purposes of the Tax Injunction Act, the parent companies effectively have alternative state remedies to pursue.

The Court of Appeals concluded that the Tax Injunction Act is inapplicable to the actions brought by Alcan and Imperial because "the Act has not been construed so broadly as to bar a nontaxpayer . . . who lacks a remedy in state court from bringing suit in federal court on the ground that an affiliated taxpayer possesses adequate state court remedies." Pet. App., at A-18.[15] But while it is

[15] In support of this proposition, the Court of Appeals cited its earlier decision in *Alcan Aluminium Ltd. v. Dept. of Revenue*, 724 F. 2d 1294 (7th Cir. 1984), which in turn cited *Capitol Indus.-EMI, Inc. v. Bennett*, 681 F. 2d 1107 (9th Cir. 1982), cert. den., 455 U.S. 943 (1982). However, each of the cases relied on in *Capitol* involved a situation where a suit for refund

(Continued on following page)

true, as the Court of Appeals observed, that California affords remedies only to the taxpaying subsidiaries, it does not automatically follow that Alcan and Imperial are thus deprived of effective state remedies. The two wholly-owned subsidiaries (which are more than "affiliated" taxpayers) unquestionably have adequate remedies in the state courts. See, e.g., *California v. Grace Brethren Church, supra*, at 415. And Alcan and Imperial, which have absolute control over their subsidiaries, obviously are in a position to ensure that these remedies are pursued with vigor. In other words, neither of the parent companies was required to bring these lawsuits to ensure a full challenge to the California taxing procedures. As the sole stockholders of their respective subsidiaries, both of the parent companies can litigate the constitutionality of California's method of taxation through the state remedies available to the actual taxpayers. Due to their total control over the actual taxpayers, the parent companies effectively *have* state remedies to pursue.

This Court has recognized, as least by way of dictum, that such practical considerations should govern the determination of whether a nontaxpayer has alternative remedies to seeking injunctive relief against taxing authorities. In *South Carolina v. Regan*, 465 U.S. 369 (1984), the State of South Carolina sought to challenge an

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was unavailable or inadequate because the taxing agency sought to collect the taxes from a person other than the original taxpayer. The *Capitol* court did not consider the argument advanced here that such a suit for refund constitutes an adequate remedy for a nontaxpayer who is the sole stockholder of the corporation against which the taxes are asserted.

amendment to section 103 of the Internal Revenue Code which placed restrictions on the types of state bonds otherwise qualifying for the exemption granted by that section. The case thus raised an issue as to the applicability of the Anti-Injunction Act (26 U.S.C. § 7421(a)), which, in language analogous to that contained in the Tax Injunction Act, bars a suit "for the purpose of restraining the assessment or collection of any [federal] tax."[16] The Court held that the State's suit was not barred by the Anti-Injunction Act because South Carolina had no other remedy and "the Act was intended to apply only when Congress has provided an alternative avenue for an aggrieved party to litigate its claims on its own behalf." 465 U.S., at 381. In a concurring opinion, Justice O'Connor questioned the breadth of the holding, suggesting that it would enable taxpayers to evade the Anti-Injunction Act by forming organizations to litigate their tax claims. *Id.*, at 386, 394. The majority gave assurances to the contrary, stating:

> "Because taxpayers have alternative remedies, it would elevate form over substance to treat such organizations as if they did not possess alternative remedies. Accordingly, such organizations could not successfully argue that the Act does not apply because they are without alternative remedies." *Id.*, at 381, n. 19.

[16] In 1966 Congress added an explicit statement to the Anti-Injunction Act which clarified that the bar pertained to suits "by any person, whether or not such person is the person against whom such tax was assessed." This Court has recognized that "[t]he 'by any person' phrase is . . . a reaffirmation of the plain meaning of . . . § 7421(a)" as it had existed prior to the 1966 amendment. *Bob Jones University v. Simon*, 416 U.S. 725, 731-732, n. 6 (1974); see also *South Carolina v. Regan, supra*, at 377-378, n. 16.

Similarly, for purposes of the Tax Injunction Act, it would elevate form over substance to treat the parent company of a wholly-owned subsidiary as lacking an alternative state remedy when the subsidiary itself has such a remedy.

The Court also emphasized in *Regan* that, in the absence of injunctive relief under the facts of that case, the "aggrieved party would be required to depend on the mere possibility of persuading a third party to assert [its] claims." *Id.*, at 381. Plainly that is not the situation here. The parent company of a wholly-owned subsidiary is not in the helpless position of being "required to depend on the mere possibility of persuading [its subsidiary] to assert [the parent's] claims." Its total control over the actual taxpayer gives the parent the power to determine precisely when, where and how the taxpayer is to pursue any constitutional objections to the asserted taxes.

The use of a shareholder's suit to avoid proscriptions against injunctive relief is, in fact, a time-*dis*honored device. As described in Professor Moore's treatise on federal practice, over a number of years following the enactment of the Anti-Injunction Act,

> "[t]he courts . . . carved out many exceptions, so that at one time much of the evil the [Act] was aimed at again became prevalent. But in order to lessen the hazard of having a court decide that a suit for an injunction to restrain the collection of a federal tax was within the [A]ct, and therefore dismiss the bill, the technique of having a shareholder sue the *corporation* and seek an injunction restraining *it* from paying the tax was evolved." 3B *Moore's Federal Practice* ¶ 23.1.16[2], at 23.1-52; emphasis in original.

This technique met with early success, but came under increasing criticism. Finally, some 50 years ago, in *Norman*

v. Consolidated Edison Co. of New York, 89 F. 2d 619 (2d Cir. 1937) one distinguished federal panel called a halt.

The plaintiff-stockholder in *Consolidated Edison* brought suit to enjoin the corporation from paying taxes imposed under title 8 of the Social Security Act. The court upheld a dismissal of the suit on the ground that the corporation itself had an adequate remedy at law in the form of a suit for refund and that the suit by the stockholder clearly was an attempt to avoid indirectly the prohibition of the Anti-Injunction Act. The court, in an opinion written by Judge Augustus Hand, stated:

> "Clearly the corporation itself could not successfully maintain a suit to enjoin collection of the taxes because of the prohibition of such suits by R.S. § 3224 (26 U.S.C.A. § 1543); but it may pay the taxes and sue to recover them back whenever the question as to the validity of the Social Security Act is determined. In the meantime there is no reason for allowing the statutory prohibition against enjoining the collection of taxes to be whittled away through the use of a stockholder's bill that makes no better showing of irreparable damage than does the one here. To sanction such a device might well result in a widespread interference with the collection of government revenues.
>
> "The plaintiff has suffered no irreparable damage to his stock interest, since his corporation has an adequate remedy at law for recovering any taxes that may turn out to be unlawful exactions. . . ." 89 F. 2d, at 624.

Later in the same year, when another stockholder's suit challenging the validity of the Social Security Act reached this Court, four of the Justices preferred to dismiss it on the authority of *Consolidated Edison*. See *Helvering v. Davis*, 301 U.S. 619, 639 (1937). However, a majority of the Court agreed that the matter could proceed on the

merits, evidently because the federal government, anxious for a decision, had "waived" the Anti-Injunction Act. No such extenuating circumstances exist here. In any case, whether particular litigation involves injunctive relief proscribed by the Anti-Injunction Act, the Johnson Act of 1934 (28 U.S.C. § 1342), or the Tax Injunction Act, it is difficult to quarrel with Professor Moore's observation that the use of a shareholder's action "in any of these fields for the purpose of circumventing the statutory policy is unsound." 3B *Moore's Federal Practice* ¶ 23.1.16[2], at 23.1-53.

C. Respondents' domestic subsidiaries are entitled to raise the same constitutional claims as the parent companies.

Circumvention of the Tax Injunction Act is the only apparent objective of the present suits brought in the names of the stockholder-parents rather than in the names of the taxpayer-subsidiaries.[17] It is disingenuous for Alcan and Imperial to claim, as they have repeatedly, that the parent companies have distinct rights under the Foreign Commerce Clause and thus must be given a forum in which to vindicate their "own" rights. As this Court has said with respect to the interstate aspects of the Commerce Clause: "The Clause protects the interstate market, not particular interstate firms, from prohibited or burdensome regulations." *Exxon Corp. v. Governor of*

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[17] The artificiality of permitting a federal action to be pursued in the name of the parent company under such circumstances is dramatically illustrated here. In each of the cases, the chief spokesman for the parent company in the federal litigation has been the house counsel for the taxpayer-subsidiary.

Maryland, 437 U.S. 117, 127-128 (1978). Stated another way, "the Commerce Clause deals with the relationship between national and state interests . . . not with the protection of individual rights." *J & J Anderson, Inc. v. Town of Erie*, 767 F. 2d 1469, 1476 (10th Cir. 1985); see also *Consol. Freightways Corp. of Del. v. Kassel*, 730 F. 2d 1139, 1144-1145 (1984).[18]

It follows from the above line of authority that any constitutional objections the parent companies may have to California's method of taxation are shared with the taxpayer-subsidiaries. It also follows that the taxpayer-subsidiaries would be able to argue in the state courts that the alleged burdens imposed on their foreign parents are of such a nature as to interfere with the congressional power to regulate foreign commerce. The tax assessments issued against the domestic subsidiaries are invalid under the Commerce Clause if they interfere with the regulatory power of Congress. Consequently, it only makes sense that the subsidiaries, as the parties directly concerned, would be entitled to complain of *any* burdens which interfere with the congressional power and hence render the tax assessments against the subsidiaries invalid. In short, it is totally illogical to assert that a corporate taxpayer is powerless to raise constitutional objections to a tax which *it* is required to pay.

[18] In both *Anderson* and *Consol. Freightways*, plaintiffs sought attorney's fees under 42 U.S.C. §§ 1983 and 1988 after challenging certain state regulations on Commerce Clause grounds. The courts held that the Commerce Clause does not secure "rights" within the meaning of § 1983. The cases demonstrate that although a party may have standing to complain of a Commerce Clause violation, this does not mean that he holds individual "rights" under that clause.

D. If the literal terms of the Tax Injunction Act do not apply, the parents' actions nevertheless should be dismissed on the basis of the principle of comity underlying the Act.

It is clear that the purposes of the Tax Injunction Act are frustrated if it is read as permitting a sole stockholder to challenge a state tax assessment in federal court when the corporate taxpayer directly concerned is barred from doing so. Accordingly, if the literal language of the Act is not sufficient to prohibit the federal relief sought by Alcan and Imperial, their actions should be dismissed on the basis of the principle of comity which underlies the Act. See, e.g., *Fair Assessment in Real Estate v. McNary*, 454 U.S. 100 (1981). The deference heretofore given to the administration of state taxes cannot be so flimsy in character as to permit federal intrusion in state tax matters simply because a federal action is brought in the name of a sole stockholder rather than the corporate taxpayer.

The Court of Appeals reached the opposite conclusion, attaching significance to what it termed California's "effective means of self-help." Pet. App., at A20. The court stated that,

> "California presumably possesses a ready remedy for unwanted federal intrusion. To eliminate federal court jurisdiction over disputes of this nature, the state need only provide foreign parent companies with a 'plain, speedy and efficient' remedy of their own in state court." *Ibid.*

The theoretical justification for providing such a remedy, apart from the coercive effect of "unwanted federal intrusion," is unclear. Moreover, the cure suggested by the Court of Appeals would likely be as disruptive of the administration of state taxes as is a federal suit seeking

injunctive relief against state tax authorities. Such disruption of state tax administration is as unnecessary as it is undesirable, for here the foreign parent companies have their own "effective means of self-help:" the total control they can exercise to direct their subsidiaries' fully adequate California remedies for testing the validity of California's tax assessments.

CONCLUSION

The judgment of the Court of Appeals reversing the dismissal of the actions filed by Alcan and Imperial should be reversed.

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